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Supreme Court, U.S.
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No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1990

DEAN WITTER REYNOLDS INC.
AND CRAIG NELSON,
Petitioners,
v.
LINDA STROTZ,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, FOURTH APPELLATE DISTRICT, DIVISION TWO

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QUESTION PRESENTED:

Whether a party's allegation that she did not read three separate contracts containing arbitration agreements before she signed them is sufficient to deny enforcement of the arbitration agreements where those agreements are within the purview of the United States Arbitration Act.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	1
STATUTES AND REGULATIONS INVOLVED	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	6
I.	
THIS COURT SHOULD GRANT A WRIT OF CERTIORARI TO SETTLE IMPORTANT QUESTIONS OF FEDERAL LAW CONCERNING ENFORCEMENT OF AGREEMENTS TO ARBITRATE	6
A. The Decision Of The California Court Of Appeal Conflicts With The Separability Rule Established By This Court In *Prima Paint Corp. v. Flood & Conklin*	7
B. The Decision Of The California Court Of Appeal Undermines The Goals Of The Arbitration Act	10
C. The Decision Of The California Court Of Appeal Is Preempted By Federal Law Under The Arbitration Act	12
CONCLUSION	15

INDEX TO APPENDICES

APPENDIX A. Opinion of the California Court of Appeal, filed August 27, 1990

APPENDIX B. Order Denying Review by the Supreme Court of the State of California, filed November 14, 1990

APPENDIX C. Statutes and Regulations Involved

APPENDIX D.

1985 Customer's Agreement

1985 Options Trading Agreement

1987 Options Trading Agreement

TABLE OF AUTHORITIES

Cases

Page

Avila Group, Inc. v. Norma J. of California, 426 F.Supp. 537 (S.D.N.Y. 1977) 14

C.B.S. Employees Federal Credit Union v. Donaldson, Lufkin and Jenrette, 912 F.2d 1563 (6th Cir. 1990) 9

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988) 7, 11, 14

Cox Broadcasting Corp. v. Cohn, 420 U.S. 469 (1975) 2

Ericksen, Arbuthnot, McCarthy & Walsh, Inc., v. 100 Oak Street, 35 Cal.3d 312, 197 Cal.Rptr. 581 (1983) 11, 12

Ford v. Shearson Lehman American Express, Inc., 180 Cal.App.3d 1011, 225 Cal.Rptr. 895 (1986) .. 5, 6

Hines v. Davidowitz, 312 U.S. 52 (1941) 13

Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 67 Cal.App.3d 19, 136 Cal.Rptr. 378 (1977) 5

Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983) 7, 13

Parris v. Dean Witter Reynolds Inc., 659 F.Supp. 928 (N.D. Ga. 1987) 8

Perry v. Thomas, 482 U.S. 483 (1987) 13

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) 4, 7-11, 13

Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960) 12

Saturn Distribution Corp. v. Williams, 905 F.2d 719 (4th Cir. 1990) 13

Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) .. 12

TABLE OF AUTHORITIES

CASES

	Page
Schneidewind v. ANR Pipeline Co., 485 U.S. 293 (1988)	13
Securities Industry Association v. Connolly, 883 F.2d 1114 (1st Cir. 1989)	7
Shotto v. Laub, 632 F.Supp. 516 (D. Md. 1986)	8
Southland Corp. v. Keating, 465 U.S. 1 (1984)	2
Supak & Sons Mfg. Co. v. Pervel Indus. Inc., 593 F.2d 135 (4th Cir. 1979)	13
Teledyne, Inc. v. Kone Corp., 892 F.2d 1404 (9th Cir. 1989)	10
Unionmutual Stock Life Ins. Co. v. Beneficial Life Ins. Co., 774 F.2d 524 (1st Cir. 1985)	8, 9
Vernon v. Drexel Burnham & Co., 52 Cal.App.3d 706, 125 Cal.Rptr. 147 (1975)	11
Volt Information Sciences, Inc. v. Stanford University, 489 U.S. 468 (1989)	10

Statutes

United States Arbitration Act	
9 U.S.C. § 1	4
9 U.S.C. § 2	2, 12, 13
9 U.S.C. § 3	2
9 U.S.C. § 4	2, 7
28 U.S.C. Section 1257(a)	2

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PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA, FOURTH APPELLATE DISTRICT, DIVISION TWO

OPINIONS BELOW

The opinion of the California court of appeal (Pet.App.A) is reported at 223 Cal.App.3d 208, 272 Cal.Rptr. 680 (1990). The order denying review by the Supreme Court of the State of California (Pet.App.B) is not reported.

JURISDICTION

The opinion of the California court of appeal was filed August 27, 1990. The order denying a petition for rehearing was filed September 21, 1990. The order of the Supreme Court of the State of California denying review after judgment by the California court of appeal was filed

November 14, 1990. Jurisdiction in this Court is invoked under 28 U.S.C. § 1257(a). *See Southland Corp. v. Keating,* 465 U.S. 1, 6-8 (1984); *Cox Broadcasting Corp. v. Cohn,* 420 U.S. 469, 482-83 (1975).

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved in this case are set forth in full in the appendix (Pet.App.C). The citations to the statutes and regulations are as follows:

United States Arbitration Act,

Section 2, 9 U.S.C. § 2

Section 3, 9 U.S.C. § 3

Section 4, 9 U.S.C. § 4

STATEMENT OF THE CASE

Respondent Linda Strotz ("Strotz") opened a securities account in 1979 with Petitioners Dean Witter Reynolds Inc. and Craig Nelson (hereinafter collectively referred to as "Dean Witter") at Dean Witter's Costa Mesa, California office. In October of 1985, Strotz transferred her account to Dean Witter's Upland, California office.

At the time of the transfer, Strotz signed two contracts governing the operation of her account. She signed a third such contract in September of 1987. Each of the contracts (Pet.App.D) contains an agreement requiring arbitration of any controversy arising out of the account.

On September 22, 1988, Strotz filed a complaint against Dean Witter in the Superior Court of the State of California for the County of San Bernardino. By her complaint, Strotz contended that her account was mismanaged be-

tween October, 1985 and October, 1987, and that she lost money in her investments. Strotz did not allege fraud in connection with any of the three contracts.

In response to the complaint, and in accordance with the arbitration agreements contained in the three contracts, Dean Witter sent a letter to Strotz' attorney requesting that Strotz voluntarily submit her claims to arbitration. One month later, Dean Witter received a responsive letter from Strotz' attorney in which he stated that Strotz would not voluntarily submit her claims to arbitration. Along with the letter, Strotz' attorney enclosed a copy of a first amended complaint which was thereafter filed with the superior court. The first amended complaint differed from the complaint in only one respect. For the first time, Strotz made general allegations of fraud concerning the inducement to enter into the two 1985 contracts and therefore sought rescission of those two contracts.[1] Strotz did not allege, however, that the arbitration agreements contained in the two contracts were obtained by fraud, nor did Strotz even mention the third contract that she signed in 1987.

In response to the first amended complaint, Dean Witter filed a petition to compel arbitration and a motion to stay proceedings (hereinafter referred to as the "petition")[2], seeking an order compelling arbitration of Strotz' claims and staying all further proceedings in the superior

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[1]The substance of Strotz' fraud allegation is that she did not read the two contracts before she signed them, and that Dean Witter indicated that the contracts were necessary to open her account but did not "advise" her of the "nature and effect" of the contracts. Pet.App.A, at 3.

[2]The pleadings filed by Dean Witter in the superior court are entitled "Petition to Compel Arbitration" and "Notice of Hearing on Petition to Compel Arbitration and Motion to Stay Proceedings."

court pending completion of the arbitration. In support of the petition, Dean Witter relied on the three contracts executed by Strotz, the mandate of the United States Arbitration Act, 9 U.S.C. § 1, *et seq.* (the "Arbitration Act") and *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). In *Prima Paint,* this Court held that as a matter of federal substantive law an arbitration agreement is "separable" from the contract in which it is contained, such that unless a party raises an independent challenge to the validity of the arbitration agreement, which Strotz did not allege, claims of fraud or other challenges to the validity of the contract as a whole must be submitted to arbitration.

Strotz filed an opposition to the petition contending that the two 1985 contracts were not binding based on alleged fraud in the inducement. Strotz relied on the allegations in the first amended complaint. Her opposition also contained an uncorroborated declaration in which she stated that she did not read the two 1985 contracts before signing them, that Dean Witter failed to disclose to her the terms of the contracts, and that had she known the terms she would not have signed the contracts. Again, Strotz made no mention of the third contract.

Dean Witter filed a reply to the opposition in which it argued that Strotz' claims should be ordered to arbitration because, among other things, Strotz raised no independent challenge to the validity of the arbitration agreements contained in the two 1985 contracts, and, more importantly, Strotz raised no challenge whatsoever to the validity of the third contract. Dean Witter received a belated "supplemental" declaration from Strotz which

contained similar, uncorroborated allegations of "fraud" with respect to the third contract.[3]

In reliance on a California state law "permeation doctrine," the superior court entered its order denying Dean Witter's petition. Those California state courts that follow the permeation doctrine hold that arbitration should be denied when allegations are made that fraud "permeated" an entire contract, on the ground that such fraud vitiates the entire contract including the agreement to arbitrate. *See, e.g., Ford v. Shearson Lehman American Express, Inc.*, 180 Cal.App.3d 1011, 1018-19, 225 Cal.Rptr. 895 (1986); *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 67 Cal.App.3d 19, 27, 136 Cal.Rptr. 378 (1977).

Dean Witter appealed the superior court's order and argued that the holding was contrary to federal law. On August 27, 1990 the California court of appeal filed its opinion (Pet.App.A) affirming the superior court's order.[4] The court properly declined to follow the permeation doctrine because it found no support for the doctrine under federal law. Pet.App.A, at 12. The court nevertheless denied arbitration in reliance upon an "alternative theory" applied in the *Ford* case. The court reasoned that an allegation of fraud in the execution is "necessarily directed" at both the contract and the arbitration agreement contained in the contract. Pet.App.A, at 13. The court concluded that a mere allegation of fraud in the

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[3]The substance of Strotz' fraud allegation with respect to the third contract is that it was mailed to her home by Dean Witter and that she did not read the contract before she signed it, even though Dean Witter represented that it was "required" for her account. Pet.App.A, at 15.

[4]The opinion was certified for publication and is reported at 223 Cal.App.3d 208, 272 Cal.Rptr. 680 (1990).

execution is "sufficient to place the issue of fraud before the court and to deny a petition to compel arbitration." *Id.* at 14.

The "alternative theory" from the *Ford* case was not briefed or argued by the parties. Dean Witter therefore filed a petition for rehearing in which it argued that the "alternative theory" utilized by the California court of appeal is, like the permeation doctrine, contrary to controlling federal law. On September 21, 1990, the court of appeal denied the petition for rehearing without comment. Dean Witter's petition for review to the Supreme Court of the State of California was denied by that court on November 14, 1990.

REASONS FOR GRANTING THE WRIT

I.

THIS COURT SHOULD GRANT A WRIT OF CERTIORARI TO SETTLE IMPORTANT QUESTIONS OF FEDERAL LAW CONCERNING ENFORCEMENT OF AGREEMENTS TO ARBITRATE

The California court of appeal's decision seriously threatens the enforcement of arbitration agreements. Under that decision, a party dissatisfied with its bargain under a contract that contains an arbitration agreement can subvert the arbitration agreement merely by alleging that he or she did not read the contract before it was signed. Such allegations, and the concomitant increase in litigation resulting from them, will become more frequent as parties who perceive advantages in judicial rather than arbitral resolution attempt to avoid their contractual

obligations.[5] Moreover, the California court of appeal's decision violates the express language of the Arbitration Act and federal case law interpreting the Act.

A. The Decision Of The California Court Of Appeal Conflicts With The Separability Rule Established By This Court In *Prima Paint Corp. v. Flood & Conklin*

Federal substantive law must be consulted by a court when determining whether to enforce an arbitration agreement within the scope of the Arbitration Act. *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983). "The availability and validity of defenses against arbitration are therefore to be governed by application of federal standards." *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988). The fraud in the execution defense utilized by the California court of appeal is contrary to the controlling federal standard established in *Prima Paint*.

The question before the Court in *Prima Paint* was "whether the federal court or an arbitrator is to resolve a claim of 'fraud in the inducement' " of the contract. 388 U.S. at 396-97. In construing section 4 of the Arbitration Act, the Supreme Court held that "arbitration clauses as a matter of federal law are 'separable' from the contracts

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[5] "The hope has long been that the [Arbitration] Act could serve as a therapy for the ailment of the crowded docket. As might be expected, there is a rub: the patient, and others in interest, often resist the treatment." *Securities Industry Association v. Connolly*, 883 F.2d 1114, 1116 (1st Cir. 1989). "[C]ourts must be on guard for artifices in which the ancient suspicion of arbitration might reappear." *Id.* at 1119. Therefore, "courts must receive the [Arbitration] Act hospitably and defend its mechanisms vigilantly and with some fervor." *Id.*

in which they are imbedded, and that where no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud." *Id.* at 402. The Court concluded that the "separability rule" is supported not only by the language of the Arbitration Act, but also by the "unmistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts." *Id.* at 404.

Accordingly, "the Arbitration Act and the case law interpreting the Act spell out a clear procedure and division of labor between the court and the arbitration panel . . . ." *Parris v. Dean Witter Reynolds Inc.*, 659 F.Supp. 928, 930 (N.D.Ga. 1987). The court will become involved only if there is "an independent challenge to the making of the arbitration clause itself." *Unionmutual Stock Life Ins. Co. v. Beneficial Life Ins. Co.*, 774 F.2d 524, 528 (1st Cir. 1985). All other disputes arising under the contract are subject to arbitration. *Id.* Therefore, "a dispute may be submitted to arbitration without a judicial decision that the contract containing the arbitration clause is valid and enforceable." *Shotto v. Laub*, 632 F.Supp. 516, 521 (D. Md. 1986).

The permeation doctrine would have permitted Strotz to defeat arbitration by merely challenging the validity of the contracts, not the arbitration agreements contained in those contracts. The California court of appeal recognized *Prima Paint's* separability rule when it declined to rely on the permeation doctrine.[6]

Nevertheless, the California court of appeal, relying on California case law, held that a challenge to the validity of

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[6]Pet.App.A, at 12.

the contracts alone based on a "fraud in the execution" defense is sufficient to defeat arbitration. The holding is contrary to federal substantive law as expressed in *Prima Paint*, because a challenge to the validity of a contract that contains an arbitration agreement, whether the challenge is based on fraud in the execution or fraud in the inducement, does not change the applicability of the separability rule.

> The teaching of *Prima Paint* is that a federal court must not remove from the arbitrators consideration of a substantive challenge to a contract unless there has been an independent challenge to the making of the arbitration clause itself. *The basis of the underlying challenge to the contract does not alter the severability principle [of Prima Paint].* (Emphasis added).

Unionmutual, 744 F.2d at 529.

In fact, the distinction under state law between fraud in the inducement and fraud in the execution will "confound [rather] than clarify the dispositive issue and its resolution." *C.B.S. Employees Federal Credit Union v. Donaldson, Lufkin and Jenrette,* 912 F.2d 1563, 1566 (6th Cir. 1990). "The central issue, reduced to its simplest, is whether [the] claim of fraud relates to the making of the arbitration agreement." *Id.*

The California court of appeal obscures the central issue and ignores *Prima Paint* by concluding that an allegation of fraud in the execution is "necessarily directed" at both the contract and the arbitration agreement contained in the contract.[7] Under federal law, there is no rule by which general allegations of fraud directed

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[7]Pet.App.A, at 13.

to the entire contract necessarily imply a challenge to the arbitration agreement contained in the contract.[8] Rather, under the separability rule "cases [must] be submitted to arbitration unless there is a challenge to the arbitration provision which is *separate* and *distinct* from any challenge to the underlying contract . . . and this is an issue on which federal law controls." *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1989).

Since the decision of the California court of appeal conflicts with federal substantive law established in *Prima Paint,* review of its decision by this Court is warranted.

B. The Decision Of The California Court Of Appeal Undermines The Goals Of The Arbitration Act

The primary goal of the Arbitration Act is the enforcement of arbitration agreements. "While Congress was no doubt aware that the Act would encourage the expeditious resolution of disputes, its passage 'was motivated, first and foremost, by a Congressional desire to enforce agreements into which parties had entered.' " *Volt Information Sciences, Inc. v. Stanford University,* 489 U.S. 468, 477 (1989).

Under the court of appeal's decision, when a dispute arises under a written contract containing an arbitration agreement, a party can merely plead ignorance with respect to the contract (e.g., "I did not read it") and

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[8]This type of rule was presented by Justice Black in his dissenting opinion in *Prima Paint.* Justice Black suggested that if a contract is unenforceable because it was fraudulently induced, the arbitration agreement contained in the contract is also necessarily unenforceable. *Prima Paint,* 388 U.S. at 425. The majority did not agree, however, and instead applied the separability rule as is required by the language of the Arbitration Act.

thereby avoid arbitration. The court of appeal improperly granted Strotz what one court has called "retrospective unilateral contractual immunity." *See Vernon v. Drexel Burnham & Co.*, 52 Cal.App.3d 706, 714, 125 Cal.Rptr. 147 (1975). The damage that such a rule will cause to the goal of enforcement of arbitration agreements is readily apparent: "[Arbitration agreements] would become no more than presumptive statements of the parties' intentions, instead of legally enforceable agreements." *Cohen,* 841 F.2d at 287-88.

Another "unmistakably clear congressional purpose of the [Arbitration Act is] . . . that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts." *Prima Paint,* 388 U.S. at 404. The Supreme Court of the State of California has noted the problem with committing preliminary issues concerning arbitration to the courts:

> Referring preliminary issues to the courts can cause 'serious delay and confusion, thus robbing the arbitration procedure of much of its value to the parties.' [Citation omitted.] And, we have recently warned against 'procedural gamesmanship' aimed at undermining the advantages of arbitration.

Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street, 35 Cal.3d 312, 323, 197 Cal.Rptr. 581 (1983).

The instant case demonstrates the type of procedural gamesmanship which undermines the advantages of arbitration. Strotz' original complaint contained no allegations of fraud with respect to the three contracts which contained arbitration agreements. When Dean Witter presented her with the contracts, Strotz responded by filing a first amended complaint that mirrored the com-

plaint, save for the addition of allegations that, although labeled by Strotz as "fraud," amount to no more than an assertion by Strotz that she failed to read two of the contracts. When Dean Witter argued in the superior court that arbitration should be ordered because there was no similar allegation in connection with the signing of the third contract, Strotz simply filed a belated "supplemental" declaration which contained allegations, albeit of a vague and conclusory nature, that the third contract was also purportedly induced by "fraud."

According to the decision of the California court of appeal, a party can belatedly plead, as Strotz did, that he or she did not read the contract and thereby avoid arbitration. The result is that " 'the mere cry of fraud . . . [will] permit the frustration of the very purposes sought to be achieved by the agreement to arbitrate, i.e., a speedy and relatively inexpensive trial before commercial specialists.' " *Ericksen*, 35 Cal.3d at 318 (emphasis omitted) (quoting *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 410 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960).

In light of the importance of the decision of the California court of appeal to the enforcement of arbitration agreements under the Arbitration Act, as well as the impact of the decision on achievement of the goals of the Act, review of its decision by this Court is warranted.

C. The Decision Of The California Court Of Appeal Is Preempted By Federal Law Under The Arbitration Act

The passage of the Arbitration Act was intended to "reverse centuries of judicial hostility to arbitration agreements." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510 (1974). Section 2 of the Arbitration Act is "a congres-

sional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone,* 460 U.S. at 24. Section 2 therefore preempts "conflicting state laws which restrict the validity or enforceability of arbitration agreements." *Supak & Sons Mfg. Co. v. Pervel Indus. Inc.,* 593 F.2d 135, 137 (4th Cir. 1979) (footnote omitted).

"State laws are subject to preemption . . . if they directly contradict federal law . . . [or] if they stand 'as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *Saturn Distribution Corp. v. Williams,* 905 F.2d 719, 722 (4th Cir. 1990) (quoting *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941) and *Schneidewind v. ANR Pipeline Co.,* 485 U.S. 293, 298 (1988)). Both grounds for preemption are present here. The decision of the California court of appeal directly contradicts the separability rule established by this Court in *Prima Paint,*[9] and it "stands as an obstacle" to effectuation of the goals of the Arbitration Act.[10]

Moreover, the California rule applied to the arbitration agreements in this case imposes a further obstacle to the enforcement of arbitration agreements. Section 2 of the Arbitration Act "requires that states place no greater restrictions upon arbitration provisions than they place upon other contractual terms." *Saturn Distribution Corp.,* 905 F.2d at 722. The focus "should be on whether [the decision of the California court of appeal] imposes burdens on arbitration agreements that do not apply to contracts generally." *Id. Accord Perry v. Thomas,* 482 U.S. 483, 489-90 (1987).

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[9]See discussion at 7-10.

[10]See discussion at 10-12.

For Strotz to prevail in her attempts to void the three contracts by a fraud in the execution defense, she must "bring [herself] within an exception to the general contract rule that a person of ordinary understanding and competence will be bound by the provisions of a contract that [s]he signs whether or not [s]he has read them." *Avila Group, Inc. v. Norma J. of California,* 426 F.Supp. 537, 540 (S.D.N.Y. 1977). The California court of appeal "excused" Strotz from this general rule in light of "allegations of a fiduciary relationship,"[11] thereby holding that Dean Witter had a duty to explain to Strotz that each of the three contracts contained arbitration agreements. However, no other court has held that a broker owes a duty to a customer to explain the terms of a contract, and courts should "decline to impose such an obligation where the language of the contract clearly and explicitly provides for arbitration of disputes arising out of the contractual relationship." *Cohen,* 841 F.2d at 287.

By applying a special California rule to contracts which contain arbitration agreements, the decision of the California court of appeal conflicts with federal law and undermines the goals of the Arbitration Act. Accordingly, review of the decision by this Court is warranted.

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[11] Pet.App.A. at 14

CONCLUSION

A review of the decision of the California court of appeal in the instant case will resolve important questions of federal law concerning the enforcement of arbitration agreements. For this reason, Petitioner Dean Witter respectfully requests that this Petition for a Writ of Certiorari to the Court of Appeal of the State of California, Fourth Appellate District, Division Two be granted.

DATED: February 12, 1991

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APPENDIX A

CERTIFIED FOR PUBLICATION

E006574

COURT OF APPEAL, FOURTH DISTRICT
DIVISION TWO
STATE OF CALIFORNIA

LINDA STROTZ,
Plaintiff and Respondent,

v.

DEAN WITTER REYNOLDS, INC. et al.,
Defendants and Appellants.

(Super.Ct.No. RCV-46406)

OPINION

Filed August 27, 1990

APPEAL from the Superior Court of San Bernardino County. William Pitt Hyde, Judge. Affirmed.

Jones, Bell, Simpson & Abbott, Michael J. Abbott and Donald C. Miller for Defendants and Appellants.

Covington & Crowe, Robert F. Schauer, Melanie Fisch and Wayne K. Baldwin for Plaintiff and Respondent.

Defendants Dean Witter Reynolds, Inc. (Dean Witter) and Craid Nelson (Nelson) appeal from an order denying their petition to compel arbitration. The trial court denied arbitration because of plaintiff's allegations in her complaint that defendants had fraudulently induced her to sign the contract which contained the agreement to arbitrate and that the fraud permeated the entire contract, including the agreement to arbitrate.

I

FACTS[1]

In October of 1985, plaintiff went to the Dean Witter office in Upland and met with Nelson for the purpose of transferring her investment account from the Dean Witter office in Costa Mesa which had managed her investments since 1979. At the time of the transfer, Nelson had plaintiff sign a "Customer's Agreement" and an "Option Client Information" agreement. Both contracts include agreements to arbitrate any controversy arising out of or related to the contract. Additionally both contracts state that all terms of the agreement shall be included in any subsequent agreement. Plaintiff signed a second "Option Client Information" agreement in 1987 which contained the same terms. In 1988, plaintiff filed suit when she learned defendants had lost her $180,000 investment, contending that defendants had misrepresented the nature of the OEX index options in which she had invested by stating they were a low risk investment when in fact they were high risk, had concealed the full extent of her losses and had sold her stock to cover her losses.

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[1]Under the federal Arbitration Act, the parties are entitled to a jury trial of the issue whether a valid agreement to arbitrate exists. (9 U.S.C.A. § 4.) "The issue, ' "should not be determined on affidavits, but rather a full trial should be had." ' " (*Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1977) 67 Cal.App.3d 19, 24.) Accordingly, in ruling on a petition to compel arbitration, the court should merely determine whether plaintiff has alleged sufficient facts of fraud directed at the making of the arbitration agreement to warrant a trial on the issue of the validity of the agreement.

The facts are taken from the plaintiff's original and first amended complaints as supplemented by the facts set forth in the declarations submitted by the parties in connection with the petition to compel arbitration.

When defendants demanded arbitration under the two contracts signed in 1985, plaintiff filed a first amended complaint wherein she alleged that at the time she signed the contracts in 1985, defendants told her that the contracts simply were documents necessary to open her account, that they did not affect her legal rights and that it was not necessary to read them. She contends she was not given the opportunity to read the documents and was not advised of the agreement to arbitrate. Additionally she alleges she was not told that the document entitled "Option Client Information" was actually a contract, the terms of which were set forth on the back of the form. Finally, plaintiff contends she did not know the true nature and effect of the documents and that had she known she would not have signed them.[2]

Defendants filed their petition to compel arbitration wherein they alleged that both the contracts signed in 1985 and the "Option Client Information" contract signed in 1987 required plaintiff to submit her claims to arbitration. In opposition to the petition to compel arbitration, plaintiff filed a declaration which in essence repeated the allegations in the complaint. She also filed a supplemental declaration in which she stated that from time to time after she opened her account with defendants, she received documents or form letters from defendants. When she received such documents, she would call defendants and ask what the documents were. Each time, defendants would tell her that it was okay to sign the documents, that it wasn't necessary to keep copies and not to worry. She further stated that she signed such documents on defend-

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[2]Plaintiff also alleges she was not informed the option agreement gave defendants the right to sell her stock to cover the losses and continues her allegations of fraud and misrepresentation about the nature of the investment in OEX Index Options.

ants' assurances that they were simply standard documents defendants required. The 1987 "Option Client Information" agreement was among the documents defendant told her wre standard forms defendants required.

II

PERMEATION DOCTRINE

In this case we are called upon to determine whether the federal Arbitration Act (9 U.S.C. § 1 et seq.) allows a party to avoid his agreement to arbitrate by use of what has been referred to by the parties as the "permeation doctrine." While the parties argue its applicability, they have not attempted to explain or define the doctrine. But then we find that the courts which have applied the permeation doctrine provide little guidance in its proper application as well. Therein lies the problem. Because the parameters of the doctrine have not been clearly defined in relation to the United States Supreme Court rule of severability under the federal Arbitration Act, we decline to rely on it. Nonetheless, as we explain, we find the trial court properly denied the petition to compel arbitration.

The federal Arbitration Act provides that, in contracts involving interstate commerce, a written arbitration agreement is valid and enforceable.[3] Accordingly, a trial court is required to order a matter to arbitration unless there are grounds for revocation of the arbitration agreement. Prior to 1967, the circuit courts of appeal had been divided on the issue of whether claims of fraud in the inducement of a contract which contained an agreement

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[3]The parties concede that this matter is governed by the federal Arbitration Act as it involves securities transactions in interstate commerce. (*Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra*, 67 Cal. App.3d 19.)

to arbitrate were subject to arbitration or were to be decided by the trial court. Some courts held as a matter of federal substantive law that the arbitration agreement was severable from the principal contract and therefore claims of fraud in the inducement of the principal contract did not invalidate the arbitration agreement. Others held that the issue of severability was to be determined under the applicable state law.

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.* (1967) 388 U.S. 395, 87 S.Ct. 1801, the United States Supreme Court resolved this conflict and held that, as a matter of federal substantive law, an arbitration clause in a contract is severable from the principal contract in which it is located. Therefore, claims of fraud or other defenses which may vitiate the principal contract do not affect the agreement to arbitrate. Accordingly, in ruling on a petition to compel arbitration or an application for a stay of court proceedings pending arbitration, the trial "court may consider only issues relating to the making and the performance of the agreement to arbitrate" and may not "consider claims of fraud in the inducement of the contract generally."[4] (*Id.*, at p. 404.) These principles were later determined to apply to any contract governed by the federal Arbitration Act whether the issue is raised in state or federal courts. (*Southland Corp. v. Keating* (1984) 465 U.S. 1, 12, 104 S.Ct. 852; *Moses H. Cone*

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[4]If the court determines the arbitration agreement is valid, it must then decide what issues are to be decided by the arbitrator. This issue is determined by reference to the language of the agreement itself. Here, as in *Prima Paint*, the parties' agreement includes "any controversy arising out of or related to the contract." Under the *Prima Paint* holding, this language is broad enough to include a claim of fraud in the inducement of the contract.

Memorial Hosp. v. Mercury Const. (1983) 460 U.S. 1, 24-25, 103 S.Ct. 927.)

In *Prima Paint*, the plaintiff alleged that it had been induced to enter a contract containing an arbitration agreement by the defendants' false representations and fraud regarding its ability to perform the contract. The court held that this fraud did not relate to the making or the performance of the agreement to arbitrate. As there was no evidence the parties intended to withhold legal issues regarding the validity of the contract from arbitration and no evidence the plaintiff was fraudulently induced to agree to arbitration, the fraud issue was to be decided by the arbitrator.[5]

Although *Prima Paint* is clear in its directive that the trial court may decide only issues of fraud directed at the making and the performance of the arbitration agreement, the courts which have applied the permeation doctrine actually have relied more on an earlier Supreme Court decision in *Moseley v. Electronic & Missile Facilities* (1963) 374 U.S. 167, 83 S.Ct. 1815, rather than *Prima Paint*. In *Moseley*, two subcontractors filed an action in Georgia and sought, in addition to other relief, an injunction enjoining the prime contractor from proceeding with its arbitration efforts in New York, contending that the Miller Act (40 U.S.C. §§ 270a-270d) gave the subcontractors the right to sue in the district court where the subcontracts were performed. The Supreme Court did not decide that issue, stating that before the issue of the

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[5]In a dissenting opinion joined in by Justices Douglas and Stewart, Justice Black strongly criticized the severability rule as being inconsistent with the legislative history of the Arbitration Act. Black also argued the rule was inconsistent with the parties' intentions. "Prima would not have agreed to . . . the arbitration clause but for F & C's fraudulent promise. . . ." (*Id.*, at p. 424.)

arbitrability of the disputes under the subcontracts could be reached, the district court must first decide the issue of fraud. In *Moseley,* the subcontractors alleged "that the subcontracts ... were a fraudulent scheme to obtain a great amount of work and material from petitioner and the other subcontractors without making payment therefor and to 'browbeat' petitioner and his fellow subcontractors into accepting much less than the value of their claims. One of the means used to effect such scheme was alleged to be the insertion in the subcontracts of an arbitration clause requiring arbitration of disputes in New York." (*Id.,* at p. 171.) In finding "that the issue of fraud should first be adjudicated before the rights of the parties under the subcontracts can be determined," the court emphasized, *"that, as alleged here, the issue goes to the arbitration clause itself, since it is contended that it was to be used to effect the fraudulent scheme."* (*Ibid.,* emphasis supplied.) The court later held that *Moseley* and *Prima Paint* were consistent. (*Prima Paint Corp. v. Flood & Conklin Mfg. Co., supra,* 388 U.S. 395, 404, fn. 12.)

Thus, when *Moseley* and *Prima Paint* are read together, they hold that, under a broadly worded arbitration provision, fraud in the making or performance of a principal contract is to be decided by the arbitrator. The issue of fraud is to be decided by the court only where it is alleged the arbitration agreement itself was obtained by fraud or is part of a fraudulent scheme. It is not sufficient to allege simply that the arbitration agreement is located in a contract which was otherwise procured by fraud.

The "permeation doctrine" apparently was originated in an appellate division of a New York trial court, applying New York law, in *Housekeeper v. Lourie* (1972) 39 A.D.2d 280, 333 N.Y.S.2d 932, appeal dismissed 32 N.Y.S.2d 832, 345 N.Y.S.2d 1018, 299 N.E.2d 261. In that

case, the allegation was that the petitioners had been induced to enter the agreement to terminate a partnership by their attorney's (respondent's) representation that the contract was the only form by which the partnership could be terminated and that if they did not sign the agreement, the partnership would continue. The contract contained an arbitration provision. In finding that the issue of fraud should be decided by the court and not an arbitrator, the court stated, "[i]n the present case, the petitioners' allegations show fraud *permeating* the entire agreement of April 1, 1970. It may not be held as a matter of law that this agreement resulted from 'arm's length negotiations' rendering applicable an assumption that, notwithstanding the alleged fraud, the dominant intention of the parties was to settle their disputes by arbitration. [Citations.] If the allegations of the petitioners are true, then the entire agreement, including the provisions for arbitration, should be avoided as constituting a fraudulent breach of the fiduciary relationship between an attorney and his clients." (*Id.*, at p. 938, emphasis supplied.)

The court in *Housekeeper* was addressing a contract governed by New York law which did not involve the federal Arbitration Act. California courts, however, subsequently applied the permeation doctrine to cases arising under the federal Arbitration Act. In *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 67 Cal.App.3d 19 and in *Ford v. Shearson Lehman American Express, Inc.* (1986) 180 Cal.App.3d 1011, the courts held that a petition to compel arbitration under the federal Arbitration Act is properly denied "where it is alleged that fraud either induced the arbitration clause itself, or permeated the entire agreement including the arbitration clause." (*Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 67 Cal.App.3d 19, 27.) The court in *Ford* did not

independently analyze the question of whether the permeation doctrine is applicable under the federal Arbitration Act but relied on *Main* for this proposition and the *Main* court relied almost exclusively on *Housekeeper* and *Moseley*.[6] The *Moseley* decision does not support the permeation doctrine because, as noted, the court in that case expressly found that the fraud was directed at the arbitration clause. Thus the sole support for the permeation doctrine appears to be the *Housekeeper* decision which as we previously mentioned was applying state law and therefore is not authority for the doctrine under the federal Arbitration Act.

We also do not believe the *Housekeeper* decision can be construed to be consistent with *Prima Paint*'s rule of severability as there were no allegations of fraud directed at the arbitration clause. There was no allegation, for example, that the plaintiffs were led to believe they had to agree to arbitration or that the arbitration agreement was part of a fraudulent scheme or that the parties never intended to agree to arbitration. In fact, there is no explanation of how or why the fraud "permeated" the contract. In our reading of the *Housekeeper* decision, it appears the court found the arbitration agreement invalid merely because it was contained within a contract which was otherwise obtained by fraud. If this is a correct interpretation, then it is inconsistent with *Prima Paint's* rule of severability and cannot be applied under the federal Arbitration Act.

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[6]The other cases relied upon by the court in *Main* do not aid in the analysis of the permeation doctrine as they either did not apply or discuss the permeation doctrine and were decided long before *Prima Paint* or merely quoted language from the *Housekeeper* decision in dicta. We do not discuss these cases.

In *Main*, the court elaborated on the permeation doctrine and affirmed the order denying the petition to compel arbitration not merely because the agreement to arbitrate was contained in a contract which was otherwise procured by fraud but because that inclusion of the arbitration agreement itself constituted constructive fraud. The court found that defendants "gained an advantage over plaintiff by inclusion, in the lending agreement, of the provision to arbitrate." *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra,* 67 Cal.App.3d 19, 31.) In reaching this conclusion, the court relied on the fact that (1) the right to select a judicial forum is a substantial right not lightly to be deemed waived; (2) a federal court had criticized the practice of securities dealers of requiring arbitration clauses; and (3) the parties in *Main,* respectively, treated the arbitration clause as an advantage to be held and a disadvantage to be invalidated. In our opinion, these factors do not support the court's conclusion.

First, whatever the law may be regarding *unilateral waiver* of the right to select a judicial forum, it is not instructive in the context of a bilateral agreement to arbitrate. Where an agreement to arbitrate exists, the parties' mutual promises to forego a judicial determination and to arbitrate their disputes provide consideration for each other. Both parties give up the same rights and thus neither gains an advantage over the other.[7]

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[7]We acknowledge that there may be arbitration provisions which do give an advantage to one party. The provision in the *Moseley* case requiring arbitration in New York for a dispute in Georgia is illustrative of an unfair arbitration agreement. Similarly, courts are less inclined to uphold a provision for arbitration before a presumptively biased arbitrator. In those cases, however, it is not the requirement of arbitration alone which makes the provision unfair but rather the place or manner in which the arbitration is to occur. Here the

Second, that one court has criticized the practice of including arbitration clauses in standardized contracts is not a basis for ignoring an agreement to arbitrate. Arbitration has received increasing support in the courts as a recognized means of resolving disputes more efficiently and more economically. (*Pacific Inv. Co. v. Townsend* (1976) 58 Cal.App.3d 1, 9-10.) In the context of adhesion contracts, the courts have held that the inclusion of an arbitration provision is not per se unconscionable, particularly in a commercial transaction. (*Izzi v. Mesquite Country Club* (1986) 186 Cal.App.3d 1309, 1318.)

Finally, the fact that one party later seeks to aviod his agreement to arbitrate cannot alone preclude enforcement of the agreement. If that were sufficient, few arbitration agreements would be enforceable.

In *Ford v. Shearson Lehman American Express, Inc., supra,* 180 Cal.App.3d 1011, the court not only approved of and applied the permeation doctrine, but further held that *Prima Paint* was not applicable. The *Ford* court distinguished *Main* and *Moseley* from *Prima Paint* on the grounds that the former cases involved allegations of fraud in the *making* of the contract while *Prima Paint* involved fraud in the *performance* of the contract. (*Id.,* at p. 1022.) Accordingly, the court in *Ford* held that fraud in the making of the contract should be decided by the court while the issue of fraud in the performance is for the arbitrator to decide. (*Id.,* at p. 1023.) We disagree with the distinction the *Ford* court made as it ignores the rule

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arbitration agreement does not favor either party as it allows the customer to elect whether the arbitration is to be governed by rules of the Arbitration Committee of the Chamber of Commerce of the State of New York, the American Arbitration Association or the Board of Arbitration of the New York Stock Exchange.

in *Prima Paint* that the arbitration agreement is severable from the principal contract.

The Supreme Court in *Prima Paint* did not hold that fraud which goes to the making of the contract is for the court and fraud related to the performance of the contract are for the arbitrator. Rather, the court specifically and expressly made a distinction between fraud which is directed at the arbitration agreement and fraud directed at the principal contract. The court quite clearly held that only fraud directed at the making or performance of the arbitration agreement is to be determined by the court. (*Prima Paint Corp. v. Flood & Conklin Mfg. Co., supra,* 388 U.S. 395, 403-404.)

Although we disagree with the analysis in both *Main* and *Ford* and find no support under federal law for the permeation doctrine, we nonetheless find that the result in the *Main* and *Ford* cases as well as in the present case is correct on the alternative theory applied in the *Ford* opinion. In *Ford,* the plaintiff alleged that at the time he signed the agreements, he was under the complete dominion and control of one of the defendants and that if he in fact signed the agreements he did not know what they were and did not know what their effect was. (*Ford v. Shearson Lehman American Express, Inc., supra,* 180 Cal.App.3d 1011, 1025-1026.) Based on these facts, the court in *Ford* also found that the complaint sufficiently alleged fraud in the inception, factum or execution to render the agreement to arbitrate void for lack of mutual assent. (*Id.,* at p. 1028.) " 'If the fraud goes to the inception or execution of the agreement, so that the promisor is deceived as to the nature of his act, and actually does not know what he is signing, or does not intend to enter into a contract at all, mutual assent is lacking, and it is *void*. . . . [Citation.]' " (*Ibid.*)

We agree that if a party is unaware he is signing any contract, obviously he also is unaware he is agreeing to arbitration. Accordingly an allegation of fraud in the inception or execution of the contract is necessarily directed at both the principal contract and the arbitration agreement contained therein.[8] In such a situation, it cannot be seriously contended that the party knew he was signing one contract but did not know he was agreeing to another agreement when the two agreements are contained in the same document.

The claim of fraud in the inception or execution is analogous to the claim that an agent lacked authority to sign an agreement discussed in *Kulukundis Shipping Co. v. Amtorg Trading Corp.* (2d Cir. 1942) 126 F.2d 978. In that case, the court properly held that the question of the agent's authority to sign a contract which contained an arbitration agreement was for the court. If the agent did not have the authority to sign the contract, the agent necessarily did not have the authority to agree to arbitration. To compel the principal to arbitrate would have meant the principal was bound by an arbitration agreement he denied making. Further, had the arbitrator determined the agent lacked the authority to sign the contract,

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[8]Similarly, the result in *Main* can be explained and upheld under this theory. In that case as well, the plaintiff had alleged a fiduciary relationship with the defendant and that because of the trust and confidence she had in defendant she was accustomed to signing documents at the defendant's request without reading the documents. (*Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra*, 67 Cal.App.3d 19, 30.) She further alleged that she did not know the true nature and effect of the documents she was signing, that defendant misrepresented the nature and content of the documents in order to induce plaintiff to sign them, and that plaintiff believed she was only signing documents necessary to open an account and would not have signed them if she knew their contents. (*Ibid.*)

the arbitrator necessarily would have determined that agent also lacked authority to agree to arbitration. With this determination, the arbitrator's decision would in turn be a nullity.

The alternate theory in *Ford* as well as the *Kulukundis* case is also consistent with *Moseley.* Had the court, in *Moseley,* referred the issue of fraud to arbitration in New York pursuant to the arbitration agreement, the court would have been assisting the defendant in its fraudulent scheme. A determination by the arbitrator that the arbitration agreement was, as the plaintiffs contended, a means to effect the fraud would have been of little value to the subcontractors who already would have incurred the time and expense of arbitrating their dispute in New York.

Accordingly, we hold that allegations of fraud in the inception or execution of a contract which contains an agreement to arbitrate are sufficient to place the issue of fraud before the court and to deny a petition to compel arbitration. Here the plaintiff has alleged that defendants deceived her as to the nature and effect of the documents she was signing and that had she known the documents contained an agreement to arbitrate, she would not have signed the documents. Plaintiff's failure to read the documents may be excusable in light of allegations of a fiduciary relationship and defendants' misrepresentations. (See 1 Witkin, Summary of Cal. Law (9th ed. 1987) Contracts, § 407, pp. 366-367.) If the court decides the issue of fraud in the execution of the documents in favor of plaintiff, litigation should proceed in court on the remaining issues, including the fraudulent representations about the index options. If, however, the court finds no fraud in the execution of the documents, plaintiff will be bound by the agreement to arbitrate and the court

should enter an order compelling arbitration. (*Ford v. Shearson Lehman American Express, Inc., supra,* 180 Cal.App.3d 1011, 1029.)

III

THE 1987 CONTRACT

Defendants also contend that since plaintiff has not set forth in her amended complaint any allegations of fraud directed at the "Option Client Information" contract signed in 1987, then, even if there was fraud in connection with the first two contracts, the court erred in denying arbitration under the third contract.[9] While it is true that the fraud alleged in the amended complaint refers only to the two contracts signed in 1985, plaintiff, in her supplemental declaration in opposition to the petition to compel arbitration, did allege that during the course of her relationship with defendants, defendants sent a number of documents requesting her signature. Each time, according to plaintiff, defendants advised her that these were simply standard forms required for her account and there was nothing to worry about. She also stated in her declaration that she signed this document in reliance on defendants' assurances that these were merely standard forms.[10] In light of the allegations of a confidential rela-

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[9]Plaintiff's failure to allege fraud in connection with this third contract is understandable. When defendants first demanded arbitration in their counsel's letter dated October 19, 1988, reference was made to only the two contracts signed in 1985, copies of which were attached to the letter. Defendants did not demand arbitration pursuant to the third contract until they filed their petition to compel arbitration which was after the plaintiff's first amended complaint was filed.

[10]Defendants did not object to the trial court's consideration of this supplemental declaration and certainly did not contend the trial

tionship existing between plaintiff and defendants at the time this contract was signed, whether it was reasonable for plaintiff to rely on defendants' assurances is a question of fact. At this time, we simply find that as is true with the other contracts, plaintiff has alleged sufficient facts of fraud in the execution of the third contract to warrant denial of defendants' petition to compel arbitration at this time.

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court was limited to the allegations of fraud set forth in the complaint. Thus any error in the trial court's consideration of this supplemental declaration was waived. We note, however, that neither the federal Arbitration Act nor our comparable state procedure for a petition to compel arbitration (Code Civ. Proc., §§ 1281-1281.8) specifically requires that the grounds for invalidating an arbitration agreement be contained in a complaint or alternatively, that they be set forth in declarations in opposition to the petition.

IV

DISPOSITION

The order denying defendant's petition to compel arbitration is affirmed. All parties to bear their own respective costs on appeal.

CERTIFIED FOR PUBLICATION

HOLLENHORST
Acting P.J.

We concur:

TIMLIN
J.

MCDANIEL
J.*

* Retired Associate Justice of the Court of Appeal sitting under assignment by the Chairperson of the Judicial Council.

APPENDIX B

ORDER DENYING REVIEW
AFTER JUDGMENT BY THE COURT OF APPEAL

Fourth Appellate District, Division Two,
No. E006574 S017778
IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

IN BANK

LINDA STROTZ,
Respondent

v.

DEAN WITTER REYNOLDS INC. Et Al.,
Appellants

Filed November 14, 1990

Appellants' petition for review DENIED.

Panelli, J. is of the opinion the petition should be granted.

LUCAS
Chief Justice

APPENDIX C

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination.

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy betwen the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the mater in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the

Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

APPENDIX D

DEAN WITTER REYNOLDS INC.
CUSTOMER'S AGREEMENT
Office 204
Account No. 17186
A.E. 025

Gentlemen:

In consideration of your accepting one or more accounts of the undersigned (whether designated by name, number or otherwise) and your agreeing to act as brokers for the undersigned in the purchase or sale of securities or commodities, the undersigned agrees as follows:

1. All transactions under this agreement shall be subject to the constitution, rules, regulations, customs and usages of the exchange or market, and its clearing house, if any, where the transactions are executed by you or your agents, and, where applicable, to the provisions of the Securities Exchange Act of 1934, the Commodities Exchange Act, and present and future acts amendatory thereof and supplemental thereto, and the rules and regulations of the Federal Securities and Exchange Commission, the Board of Governors of the Federal Reserve System and of the Secretary of Agriculture in so far as they may be applicable.

2. Whenever any statute shall be enacted which shall affect in any manner or be inconsistent with any of the provisions hereof, or whenever any rule or regulation shall be prescribed or promulgated by the New York Stock Exchange, the Federal Securities and Exchange Commission, the Board of Governors of the Federal Reserve System and/or the Secretary of Agriculture which shall affect in any manner or be inconsistent with any of the

provisions hereof, the provisions of this agreement so affected shall be deemed modified or superseded, as the case may be, by such statute, rule or regulation, and all other provisions of the agreement and the provisions as so modified or superseded, shall in all respects continue and be in full force and effect.

3. Except as herein otherwise expressly provided, no provision of this agreement shall in any respect be waived, altered, modified or amended unless such waiver, alteration, modification or amendment be committed to writing and signed by a member of your organization.

4. All monies, securities, commodities or other property which you may at any time be carrying for the undersigned or which may at any time be in your possession for any purpose, including safekeeping, shall be subject to a general lien for the discharge of all obligations of the undersigned to you, irrespective of whether or not you have made advances in connection with such securities, commodities or other property, and irrespective of the number of accounts the undersigned may have with you.

5. All securities and commodities or any other property, now or hereafter held by you, or carried by you for the undersigned (either individually or jointly with others), or deposited to secure the same, may from time to time and without notice to me, be carried in your general loans and may be pledged, re-pledged, hypothecated or re-hypothecated, separately or in common with other securities and commodities or any other property, for the sum due to you thereon or for a greater sum and without retaining in your possession and control for delivery a like amount of similar securities or commodities.

6. Debit balances of the accounts of the undersigned shall be charged with interest, in accordance with your usual custom, and with any increase in rates caused by money market conditions, and with such other charges as you may make to cover your facilities and extra services.

7. You are hereby authorized, in your discretion, should the undersigned die or should you for any reason whatsoever deem it necessary for your protection, to sell any or all of the securities and commodities or other property which may be in your possession or which you may be carrying for the undersigned (either individually or jointly with others), or to buy in any securities, commodities or other property of which the account or accounts of the undersigned may be short, or cancel any outstanding orders in order to close out the account or accounts of the undersigned in whole or in part or in order to close out any commitment made in behalf of the undersigned. Such sale, purchase or cancellation may be made according to your judgment and may be made, at your discretion, on the exchange or other market where such business is then usually transacted, or at public auction or at private sale, without advertising the same and without notice to the undersigned or to the personal representatives of the undersigned, and without prior tender, demand or call of any kind upon the undersigned or upon the personal representatives of the undersigned, and you may purchase the whole or any part thereof free from any right of redemption, and the undersigned shall remain liable for any deficiency; it being understood that a prior tender, demand or call of any kind from you, or prior notice from you, of the time and place of such sale or purchase shall not be considered a waiver of your right to sell or buy any securities and/or commodities and/or other property held by you, or owed you by the undersigned, at any time as hereinbefore provided.

8. The undersigned will at all times maintain margins for said accounts, as required by you from time to time.

9. The undersigned undertakes, at any time upon your demand, to discharge obligations of the undersigned to you, or, in the event of a closing of any account of the undersigned in whole or in part, to pay you the deficiency, if any, and no oral agreement or instructions to the contrary shall be recognized or enforceable.

10. In case of the sale of any security, commodity, or other property by you at the direction of the undersigned and your inability to deliver the same to the purchaser by reason of failure of the undersigned to supply you therewith, then and in such event, the undersigned authorizes you to borrow any security, commodity, or other property necessary to make delivery thereof, and the undersigned hereby agrees to be responsible for any loss which you may sustain thereby and any premiums which you may be required to pay thereon, and for any loss which you may sustain by reason of your inability to borrow the security, commodity, or other property sold.

11. At any time and from time to time, in your discretion, you may without notice to the undersigned apply and/or transfer any or all monies, securities, commodities and/or other property of the undersigned interchangeably between any accounts of the undersigned (other than from Regulated Commodity Accounts).

12. It is understood and agreed that the undersigned, when placing with you any sell order for short account, will designate it as such and hereby authorizes you to mark such order as being "short", and when placing with you any order for long account, will designate it as such and hereby authorizes you to mark such order as being "long". Any sell order which the undersigned shall desig-

nate as being for long account as above provided, is for securities then owned by the undersigned and, if such securities are not then deliverable by you from any account of the undersigned, the placing of such order shall constitute a representation by the undersigned that it is impracticable for him then to deliver such securities to you but that he will deliver them as soon as it is possible for him to do so without undue inconvenience or expense.

13. In all transactions between you and the undersigned, the undersigned understands that you are acting as the brokers of the undersigned, except when you disclose to the undersigned in writing at or before the completion of a particular transaction that you are acting, with respect to such transaction, as dealers for your own account or as brokers for some other person.

14. Reports of the execution of orders and statements of the accounts of the undersigned shall be conclusive if not objected to in writing, the former within two days, and the latter within ten days, after forwarding by you to the undersigned by mail or otherwise.

15. Communications may be sent to the undersigned at the address of the undersigned given below, or at such other address as the undersigned may hereafter give you in writing, and all communications so sent, whether by mail, telegraph, messenger or otherwise, shall be deemed given to the undersigned personally, whether actually received or not.

16. Any controversy between you and the undersigned arising out of or relating to this contract or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either the Arbitration Committee of the Chamber of Commerce of the State of New York, or the American Arbitration Association, or the

Board of Arbitration of the New York Stock Exchange, as the undersigned may elect. If the undersigned does not make such election by registered mail addressed to you at your main office within five (5) days after receipt of notification from you requesting such election, then the undersigned authorizes you to make such election in behalf of the undersigned. Any arbitration hereunder shall be before at least three arbitrators and the award of the arbitrators, or of a majority of them, shall be final, and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

17. This agreement and its enforcement shall be governed by the laws of the State of New York and its provisions shall be continuous; shall cover individually and collectively all accounts which the undersigned may open or re-open with you, and shall enure to the benefit of your present organization, and any successor organization, irrespective of any change or changes at any time in the personnel thereof, for any cause whatsoever, and of the assigns of your present organization or any successor organization, and shall be binding upon the undersigned and/or the estate, executors, administrators and assigns of the undersigned.

18. The undersigned, if an individual, represents that the undersigned is of full age, that the undersigned is not an employee of any exchange, or of any corporation of which any exchange owns a majority of the capital stock, or of a member of any exchange, or of a member firm or member corporation registered on any exchange, or of a bank, trust company, insurance company or of any corporation, firm or individual engaged in the business of dealing, either as broker or as principal, in securities, bills of exchange, acceptances or other forms of commercial paper. The undersigned further represents that no

one except the undersigned (and, to the extent community property stands in the account or accounts, his or her spouse) has an interest in the account or accounts of the undersigned with you.

19. The undersigned acknowledges receipt of your statement of interest charges.

Very truly yours,

Dated, October 28, 1985 Linda Strotz
Upland, CA

CUSTOMER'S LOAN CONSENT

Until you receive written notice of revocation from the undersigned, you are hereby authorized to lend, to yourselves as brokers or to others, any securities held by you on margin for the account of, or under the control of, the undersigned.

Dated, October 28, 1985 Linda Strotz
Upland, CA

DEAN WITTER REYNOLDS INC.

OPTION CLIENT INFORMATION

Oct. 29, 1985

☐ New Account ☐ Data Update
Date Completed: 10-28-85
Account Number: 20401718601025
Full Account Title: Linda Strotz
Occupation: (indicate former occupation if retired.)
Student ☐ Retired
Employer:
Spouse's Occupation (indicate former occupation if retired.)
☐ Retired
Spouse's Employer:
Age: ☐ Under 25 ☐ 25-39 ☒ 40-50 ☐ 51-65 ☐ Over 65
Marital Status:
☐ Single ☐ Married ☒ Widowed ☐ Divorced
Number of Dependents: 1
☐ New Account ☒ Established Relationship Since 1984
Type of Account: ☒ Margin ☐ Cash
☐ Related to DWR Employee. If so, relationship:
Approx. Annual Income (All Sources): 30M
Approx. Net Worth (Excluding Residence): 150M
Approx. Liquid Net Worth (Securities, Cash, etc.): 90M
Current Acct. Equity: 97M
Previous Investment Experience (Since what year?)
Stocks 1982 Bonds 19__ Options 1984
Commodities 19__
Bank Reference:
Option Accounts with Other Firms:
Firm Name: Since 19___
Type: ☐ Cash ☐ Margin

Firm Name: Since 19___

Type: ☐ Cash ☐ Margin

☐ Power of Attorney ☐ Discretionary Authorization

DWR Employee ☐ Third Party Agreement on File

Name of Authorized Party:

Relationship:

Investment Experience: Stocks 19___ Options 19___

Commod. 19___

Investment Objectives (Number in order of priority):

1 Income (Covered Call writing only)

2 Investment Hedge

3 Speculative Income

4 Speculation

__ Other:

Anticipated Types of Options Transactions:

☐ Covered Call Writing Only

☐ Purchasing Options

☐ Equal Quantity Spreads

☐ Uncovered Writing/Ratio Writing

☐ Put Writing (Full deposit of strike price)

☒ All Types of Option Trading

I/We certify that the foregoing information is accurate and agree to advise you in writing of any changes in my/our financial situation and/or investment objectives. FURTHER, I/WE ACKNOWLEDGE RECEIPT OF A CURRENT OPTION CLEARING CORPORATION PROSPECTUS AND UNDERSTAND THE INFORMATION CONTAINED THEREIN. FURTHER, I/WE HAVE READ, UNDERSTAND AND AGREE TO BE BOUND BY THE PROVISIONS OF THE OPTION AGREEMENT ON THE REVERSE SIDE OF THIS FORM.

Client Signature: Linda Strotz Date: 10/18/85

Client Signature (if joint): Date:

A P P R O V A L S — Internal Use Only

I have reviewed the foregoing information, that it is accurate to the best of my knowledge, and believe that the anticipated option trading is appropriate. Further, I have furnished a current Options Clearing Corporation Prospectus to the customer on (date) 8/15/85

Account Executive — Print Name: Craig S. Nelson
Signature: Craig Nelson Date: 10-28-85

I have reviewed the foregoing and have ☒ Approved ☐ Disapproved the account for options trading ☒ As Noted Above or as follows:

☐ Covered Call Writing Only ☐ Purchasing Options
☐ Equal Qty. Spreads
☐ Uncovered Writing/Ratio Writing
☐ Put Writing ☐ All Types
☐ (Full deposit of Strike Price)

Branch Manager — Print Name: Richard Flee
Signature: Richard Flee Date: 10/29/85

Registered Options Principal — Print Name:
Richard Flee Signature: Richard Flee
Date: 10/29/85

OPTIONS TRADING AGREEMENT

To Dean Witter Reynolds:

This letter is written to you in connection with puts, calls, and other forms of options which you may purchase, sell, exercise or endorse for my account. I realize that options exchanges are intended to provide a secondary market where options positions can be liquidated at any time, but there is no guarantee that such liquidity will be consistently available. I further understand the risks of buying and selling options and that options are not for everybody and that their suitability is dependent upon the circumstances of the individual investor.

In consideration of your handling options transactions for my account, I agree that:

1. I will be bound by the constitutions, rules, regulations, customs, usages and by-laws of the Exchanges, Options Clearing Corporation, or other marketplace and their clearing house, if any, where transactions are executed.

2. I will not, acting alone or in concert with others, directly or indirectly, hold, control or write in excess of the number of options contracts fixed from time to time by the exchanges or market as the position limit for one or more classes or series of options.

3. I will not exercise a long position in any option contract where, acting alone or in concert with others, directly or indirectly, I have or will have exercised in excess of the number of option contracts as may be fixed from time to time by the exchanges or market.

4. I hereby authorize you in your discretion, should I die or should you deem it necessary for your protection, to buy, sell, or sell short for my account and risk, puts, calls, or other forms of options and/or to buy, sell, or sell short any part or all of the underlying shares represented by options endorsed by you for my account. Any and all expenses incurred by you in connection with such transactions will be reimbursed by me.

5. All monies, securities or other property which you may hold in any account of mine shall be held subject to a general lien for the discharge of my obligations to you under this agreement.

6. Any controversy between us arising out of or relating to this agreement or the breach thereof shall be settled by arbitration, in accordance with the rules, then obtaining, of either the American Arbitration Association, the Board of Arbitration of the New York Stock Exchange, the American Stock Exchange, the Chicago Board Options Exchange or the National Association of Securities Dealers, Inc. as I may elect. If I do not make such an election by registered mail addressed to you at your main office within five (5) days after receipt of notification from you requesting such election, then I authorize you to make such election in my behalf.

7. This agreement and its enforcement shall be governed by the laws of the State of New York and its provisions shall be continuous; shall cover individually and collectively all accounts which I may open or re-open with you, and shall enure to the benefit of your present organization, and any successor organization, and of the assigns of your present organization or any successor organization, and

shall be binding upon me and/or my estate, executors, administrators and assigns.

8. All other agreements existing between us or hereafter made, which, by their terms apply to all accounts of mine with you, shall be applicable to my options account or accounts where they are not in conflict with this agreement. Should a conflict exist it shall be resolved in favor of this agreement. Otherwise, the provisions of each agreement shall be applicable.

9. I am aware of your requirements and time limitations for accepting an exercise notice, and, at expiration date, I understand that I may not receive actual notice of an exercise until the week following.

10. I have been advised of your policies regarding margining of options and related transactions and agree to be bound thereby.

11. I understand and acknowledge that, when transactions on my behalf are to be executed in options traded in more than one marketplace, in the absence of my specific instructions, you may use your discretion in selecting the market in which to enter my order.

12. I recognize the fact that, in connection with option trading, situations arise whereby customers neglect to instruct their broker with respect to the disposition of expiring profitable options. If such options are allowed to expire they become worthless. These are commonly referred to as "abandoned options". In this connection, in order to avoid the loss to me in connection with expiring options I hereby authorize D.W.R., in its absolute discretion, to exer-

cise any and all profitable options that are long in my account at the time of their expiration and, as to the disposition of which, I have not previously given D.W.R. contrary instructions. If D.W.R. elects to exercise this discretionary authority it is agreed that D.W.R. will attempt to advise me thereof on the first business day following expiration. In the event D.W.R. is unable to contact me or in the event I do not enter contrary instructions, D.W.R. is hereby authorized to liquidate the securities credited to my account as a result of the exercise of the options and to credit my account in a fair and equitable manner after the deduction of a service charge. Under no circumstance will my account be debited with a loss as a result of such transactions.

13. I am aware that exercise assignment notices for option contracts are allocated among D.W.R. customer short positions pursuant to an automated procedure which randomly selects from among all customer short option positions, including positions established on the day of assignment, those contracts which are subject to exercise. All short option positions are liable for assignment at any time. I may request a more detailed description of your random allocation procedure at any time.

DEAN WITTER REYNOLDS INC.

OPTION CLIENT INFORMATION

September 16, 1987

☐ Option New Account ☒ Account Data Update
Date Completed: 9-10-87
Account Number: 204 017186 0 025
PERSONAL & FINANCIAL DATA
To be completed by customer(s):
Full Account Title: Linda Strotz
Occupation (Indicate former occupation if retired.):
Not Employed ☐ Retired
Employer:
Spouse's Occupation (Indicate former occupation if retired.): Deceased ☐ Retired
Spouse's:
Age: ☐ Under 25 ☐ 25-39 ☒ 40-49 ☐ 50-65 ☐ Over 65
Marital Status: ☐ Single ☐ Married ☒ Widowed
☐ Divorced ☐ No. of Dependents ___
☐ New Account ☐ Established Relationship Since___
Type of Account: ☒ Margin ☐ Cash
Related to DWR Employee: ☐ If so, relationship:
Approx. Annual Income (All Sources): 40M
Approx. Net Worth: (Excluding Residence): 500M
Approx. Liquid Net Worth
(Securities, Cash, etc.): 100M
Current Account Equity: 100M
Additional Financial Information May Be Required
Previous Investment Experience (Since what year?)
Options 1985 Stock 1978 Commodities 19__ Bonds 78
Bank Reference: Bank of America
THIRD PARTY:
☐ Power of Attorney
☐ Discretionary Authorization for DWR Employee
☐ Third Party Agreement on File

Name of Authorized Party:
Relationship:
Investment Experience: Stocks 19___ Options 19___
Commodities 19___

OBJECTIVES STRATEGIES:
Type of Options (code):
☒ E = Equity ☐ F = Foreign Currency
☐ I = Index ☐ D = Debt
Investment Objectives (in order of priority):
4 Income
3 Aggressive Income
2 Investment Hedge
1 Speculation

Anticipated Type of Option Trading:

CODES	STRATEGY	OBJECTIVES
☒ A	Protective Put Buying Covered Call Writing	Investment Hedge Income/Investment Hedge
☒ B	Spreads	Speculation
	Put/Call Buying	Speculation
	Straddle/Combo Buying	Speculation
☒ C	Straddle/Combo Writing	Speculation/Aggressive Income
	Ratio Writing	Speculation/Aggressive Income
	Uncovered Options Writing	Speculation/Aggressive Income

Higher alphabetical codes include strategies in lower alphabetical codes.

CUSTOMER ACKNOWLEDGMENT

I/We certify that the foregoing information is accurate and agree to advise you in writing of any changes in my/our financial situation and/or investment objectives. Further, I/we acknowledge receipt of a current copy of "Characteristics and Risks of Standardized Options" and understand the Information contained therein. Further, I/we have read, understand and agree to be bound by the provisions of the Options Agreement on the reverse side of this form.

RISK DISCLOSURE STATEMENT

Buying and selling option contracts can involve substantial risk of loss. Prior to engaging in any option transaction, you should review your present financial situation with your broker and determine whether it is advisable to incur the risks of loss associated with that particular investment.

You should be aware that selling uncovered options, especially selling index option contracts places the seller in an extremely risky position and subjects the investor to a potentially unlimited loss.

It is important that you take time to read and understand the pamphlet "Characteristics and Risks of Standardized Options". If you have any questions whatsoever about your option investment, do not hesitate to speak with the branch office manager.

Client Signature: Linda Strotz Date: 9-10-87
Client Signature (if joint): Date:
AE APPROVAL:

A P P R O V A L S — Internal Use Only

I have reviewed the foregoing information, it is accurate to the best of my knowledge, and I believe that the

anticipated option trading is appropriate. Further, I have furnished a current copy of the "Characteristics and Risks of Standardized Options" to the client(s) on (date).

Account Executive — Print Name: Craig Nelson
Signature: Craig Nelson Date: 9-10-87

BRANCH MANAGER & ROP:

I have reviewed the foregoing and have ☒ Approved Options trading..... ☒ As Noted Above or as follows:
☐ Disapproved the account for:
☐ A ☐ B ☐ C
Branch Manager (Print Name): Richard F. Lee
Signature: Richard Lee Date: 9/10/87
Registered Options Principal (Print Name):
Richard F. Lee Signature: Richard Lee
Date: 9/10/87

OPTIONS TRADING AGREEMENT

To Dean Witter Reynolds:

This letter is written to you in connection with puts, calls, and other forms of options which you may purchase, sell, exercise or endorse for my account. I realize that options exchanges are intended to provide a secondary market where options positions can be liquidated at any time, but there is no guarantee that such liquidity will be consistently available. I further understand the risks of buying and selling options and that options are not for everybody and that their suitability is dependent upon the circumstances of the individual investor.

In consideration of your handling options transactions for my account, I agree that:

1. I will be bound by the constitutions, rules, regulations, customs, usages and by-laws of the Exchanges, Options Clearing Corporation, or other marketplace and their clearing house, if any, where transactions are executed.

2. I will not, acting alone or in concert with others, directly or indirectly, hold, control, or write in excess of the number of options contracts fixed from time to time by the exchanges or market as the position limit for one or more classes or series of options.

3. I will not exercise a long position in any option contract where, acting alone or in concert with others, directly or indirectly, I have or will have exercised in excess of the number of option contracts as may be fixed from time to time by the exchanges or market.

4. I hereby authorize you in your discretion, should I die or should you deem it necessary for your protection, to buy, sell, or sell short for my account and risk, puts, calls, or other forms of options and/or to buy, sell, or sell short any part or all of the underlying shares represented by options endorsed by you for my account. Any and all expenses incurred by you in connection with such transactions will be reimbursed by me.

5. All monies, securities or other property which you may hold in any account of mine shall be held subject to a general lien for the discharge of my obligations to you under this agreement.

6. And you agree by carrying any account in which I have an interest that all controversies between me and you or your agents, representatives or employees arising out of or concerning any such account, any transactions between us or for such account, or the construction, performance or breach of this or any other agreement between us, whether entered into prior, on or subsequent to the date below, shall be determined by arbitration in accordance with the rules of the National Association of Securities Dealers, Inc. or the New York Stock Exchange, or any other arbitration facility provided by any other exchange of which you are a member and in which a transaction giving rise to a claim took place, as I may elect. If I do not make such an election by registered mail addressed to you at your office within five (5) days after receipt of notification from you requesting such election, then I authorize you to make such election for me. Any arbitration proceeding between us shall be held at the location at which the selected forum regularly conducts

such proceedings nearest to your office carrying my accounts. You and I agree that neither of us shall seek an award of punitive damages against the other. The arbitrators, whose award shall be final, shall be empowered to award only compensatory damages for injuries actually incurred, and shall have no power to award punitive damages. Judgment on the award rendered may be entered in any state or federal court having jurisdiction.

I understand that the foregoing agreement to arbitrate does not constitute a waiver of the right to seek to resolve claims arising under the federal securities laws in a judicial forum where such a waiver would be void under the federal securities laws. Since this is a matter that may be resolved by the courts on a case by case basis, I understand that you reserve the right to move to compel arbitration of any such claim. Claims arising under the federal securities laws may be resolved by arbitration if I voluntarily agree to such a proceeding after the claim arises.

7. This agreement and its enforcement shall be governed by the laws of the State of New York and its provisions shall be continuous; shall cover individually and collectively all accounts which I may open or re-open with you, and shall enure to the benefit of your present organization, and any successor organization, and of the assigns of your present organization or any successor organization, and shall be binding upon me and/or my estate, executors, administrators and assigns.

8. All other agreements existing between us or hereafter made, which, by their terms apply to all accounts of mine with you, shall be applicable to my

options account or accounts where they are not in conflict with this agreement. Should a conflict exist it shall be resolved in favor of this agreement. Otherwise, the provisions of each agreement shall be applicable.

9. I am aware of your requirements and time limitations for accepting an exercise notice, and, at expiration date, I understand that I may not receive actual notice of an exercise until the week following.

10. I have been advised of you policies regarding margining of options and related transactions and agree to be bound thereby.

11. I understand and acknowledge that, when transactions on my behalf are to be executed in options traded in more than one marketplace, in the absence of my specific instructions, you may use your discretion in selecting the market in which to enter my order.

12. I recognize the fact that, in connection with option trading, situations arise whereby customers neglect to instruct their broker with respect to the disposition of expiring profitable options. If such options are allowed to expire they become worthless. These are commonly referred to as "abandoned options". In this connection, in order to avoid the loss to me in connection with expiring options I hereby authorize D.W.R., in its absolute discretion, to exercise any and all profitable options that are long in my account at the time of their expiration and, as to the disposition of which, I have not previously given D.W.R. contrary instructions. If D.W.R. elects to exercise this discretionary authority it is agreed

that D.W.R. will attempt to advise me thereof on the first business day following expiration. In the event D.W.R. is unable to contact me or in the event I do not enter contrary instructions. D.W.R. is hereby authorized to liquidate the securities credited to my account as a result of the exercise of the options and to credit my account in a fair and equitable manner after the deduction of a service charge. Under no circumstance will my account be debited with a loss as a result of such transactions.

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Supreme Court, U.S.
FILED
MAR 11 1991
OFFICE OF THE CLERK

(2)

No. 90-1300

In The

Supreme Court of the United States

October Term, 1990

DEAN WITTER REYNOLDS, INC.
and CRAIG NELSON,

Petitioners,

v.

LINDA STROTZ,

Respondent.

**Petition For A Writ Of Certiorari
To The Court Of Appeal
Of The State Of California,
Fourth Appellate District, Division Two**

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

MELANIE FISCH*
ROBERT F. SCHAUER
COVINGTON & CROWE
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Counsel for Respondent Linda Strotz

*Counsel of Record

March 11, 1991

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTION PRESENTED

Whether arbitration clauses contained in three seperate agreements are enforceable under the Federal Arbitration Act, where the agreements and the arbitration clauses therein were procured through fraud in the execution, and where the parties seeking to enforce the arbitration clauses breached their fiduciary duty to disclose to the other party all material facts concerning the principal agreements and the arbitration clauses.

TABLE OF CONTENTS

Page

JURISDICTION 1

STATEMENT OF THE CASE 1

MISSTATEMENTS OF FACT AND LAW IN THE PETITION FOR WRIT OF CERTIORARI SUPPORT DENIAL OF THE PETITION 6

REASONS FOR DENYING THE PETITION 9

I. THE DECISION OF THE CALIFORNIA COURT OF APPEAL IS CONSISTENT WITH THE LANGUAGE OF THE ARBITRATION ACT AND THE SEPARABILITY RULE 10

II. THE DECISION OF THE CALIFORNIA COURT OF APPEAL DOES NOT UNDERMINE THE GOALS OF THE ARBITRATION ACT 14

III. THE DECISION OF THE CALIFORNIA COURT OF APPEAL IS NOT PREEMPTED BY FEDERAL LAW UNDER THE ARBITRATION ACT 16

CONCLUSION 18

TABLE OF AUTHORITIES

Page

CASES

Cancanon v. Smith Barney, Harris, Upham & Co., 805 F.2d 998 (11th Cir. 1986) 12, 13

Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988) 12, 17

Ford v. Shearson Lehman American Express, Inc., 180 Cal.App.3d 1011, 225 Cal.Rptr. 895 (1986) .. 6, 7, 8, 17

Main v. Merrill Lynch, Pierce, Fenner & Smith, 67 Cal.App.3d 19, 136 Cal.Rptr. 378 (1977) 6, 7, 17

Moseley v. Electronic & Missile Facilities, Inc., 374 U.S. 167, 83 S.Ct. 1815, 10 L.Ed.2d 818 (1963) 11, 12, 13

Perry v. Thomas, 482 U.S. 483, 107 S.Ct. 2332, 96 L.Ed.2d 428 (1987) 16

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967) ..... *passim*

Southland Corp. v. Keating, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984) 17

Volt Information Sciences, Inc. v. Stanford University, 489 U.S. 468, 109 S.Ct. ___, 103 L.Ed.2d 488 (1989) 14

STATUTES

9 U.S.C. section 2 14

9 U.S.C. section 3 10

9 U.S.C. section 4 10

28 U.S.C. section 1257(a) 1

Respondent Linda Strotz respectfully prays that this Court deny the Petition for a Writ of Certiorari ("Petition") filed by Dean Witter Reynolds, Inc., and Craig Nelson on February 12, 1991.

JURISDICTION

This Court has jurisdiction in this matter pursuant to 28 U.S.C. § 1257(a).

STATEMENT OF THE CASE

In about November 1979, Respondent Linda Strotz ("Strotz") opened an investment account at Petitioner Dean Witter Reynolds, Inc. ("DWR"). Strotz, a young widow, opened the account with proceeds of a life insurance policy she received on the death of her husband. She had no previous experience investing money in securities. Strotz was evaluated by DWR as an unsophisticated client whose primary investment objectives were to earn income and safeguard her principal. Accordingly, DWR invested her funds in conservative stocks.

Strotz' problems began in October 1985, when she transferred her account to DWR's Upland office, and Petitioner Craig Nelson ("Nelson") became her account executive. From the outset, DWR and Nelson (collectively, "Petitioners") urged Strotz to invest in "OEX index options." OEX index options are extremely risky investments, totally unsuited to an inexperienced investor who wishes to protect principal and earn interest. However,

Petitioners misrepresented these facts and advised Strotz that OEX index options were safe, sure, and conservative investments. Petitioners' representations convinced Strotz to invest in OEX index options.

In connection with the transfer of her account, Petitioners required Strotz to sign documents, including a Customer's Agreement and an Option Client Information form[1] ("the 1985 contracts"). Unbeknownst to Strotz, both documents were standardized, preprinted contracts of adhesion, which were prepared, presented and imposed on Strotz by Petitioners without any opportunity for her to negotiate any of the terms of the contracts, including the arbitration clauses contained therein. Petitioners shoved the documents in front of Strotz, gave her no opportunity to read them, affirmatively told her it was not necessary to read them, and told her the documents were for the sole purpose of opening her account and that they did not affect her legal rights. Petitioners failed to advise Strotz that these documents were contracts, or that they contained arbitration clauses. Strotz, who was untrained and inexperienced in investing, did not know or understand that these documents, including the arbitration clauses, were, in fact, contracts and not simply forms to open her account. Had she known the true nature and contents of the documents, she would not have signed them. Strotz believed she was signing documents which merely opened her Upland account with

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[1] The title of this document gives no clue that it is in fact a contract with legal effect. Two such forms are reprinted in Petitioner's Appendix D at 8d-14d and 15d-18d. The appearance of these forms as shown in Appendix D is misleading and bears no resemblance to the appearance of the actual documents imposed on Strotz.

DWR and did not understand the intended effect of the arbitration clauses. Strotz therefore never agreed to submit all controversies arising from the agreements to arbitration. *See* Appendix A to Petition ("Pet.App.A") at 3a.

Thereafter, Petitioners invested Strotz' account in OEX index options. Petitioners controlled Strotz' account, and she at all times relied on their advice, recommendations, superior knowledge and skills in making investments. Strotz placed her total confidence and trust in Petitioners, relied on their judgment and expertise, and believed they would deal fairly and justly with her in all matters. Therefore, a fiduciary and/or confidential relationship existed between Strotz and Petitioners.

Petitioners made an excessive number of OEX index options transactions for Strotz' account without Strotz' knowledge or consent and at times when Strotz' account lacked sufficient funds to cover the transactions. Petitioners made these excessive transactions to earn excessive commissions, at Strotz' expense. Petitioners wrote the transactions knowing that OEX index options are in fact extremely risky investments which should not be undertaken by anyone with inadequate net worth and whose investment purpose is to protect principal and earn a reasonable income.

Throughout 1985, Petitioners lost substantial funds belonging to Strotz by investing her account in OEX index options. Petitioners failed to inform Strotz fully of the extent of her actual losses as a result of their investment advice and activities.

From time to time, Petitioners sent Strotz documents and form letters in the mail. Strotz would call Nelson to ask about the documents. Nelson always assured Strotz the documents were just standard documents, required by DWR in connection with its accounts, that there was no cause to worry, that she should sign them, and that she did not need to keep copies. Here again, Strotz did not know that one of these documents, a second Option Client Information,[2] was a contract containing a fine-print, boilerplate arbitration clause. She did not know or understand the true nature and contents of this document and did not know it contained an arbitration clause. If she had known these facts, she would not have signed the document. Strotz, in fact, never agreed to the arbitration clause therein.

Throughout 1986 and 1987, Petitioners continued to make excessive and inappropriate trades against Strotz' account, and failed to advise her of the full extent of her losses. In about mid-October 1987, Petitioners lost Strotz' entire account from their investments in OEX index options. Petitioners then sold all of Strotz' stock and property in their possession to cover the OEX index option transactions. As a result, Strotz lost at least $180,000.00.

On or about September 22, 1988, Strotz filed a verified complaint against Petitioners in the California Superior Court for the County of San Bernardino, West District. Thereafter, on November 22, 1988, Strotz filed a

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[2] A box at the top of the form shows the purpose of the document is "Account Data Update." *See* Appendix D to Petition at 15d.

verified first amended complaint against Petitioners. The first amended complaint includes causes of action for rescission and voiding of the agreements based on, inter alia, fraud in the inducement and fraud in the execution.

Petitioners then filed a petition to compel arbitration and a motion to stay proceedings. Strotz filed opposition to the petition, including two declarations of Strotz. The declarations amplified the allegations in the verified first amended complaint regarding the misrepresentations of Petitioners as to the three agreements and the arbitration clauses at issue. The declarations supported the allegations of fraud in the execution and in the inducement of both the subject agreements and the arbitration clauses contained therein. The trial court issued an order denying the petition to compel arbitration.

Petitioners appealed the order and argued, inter alia, that Strotz could not avoid the agreements by failing to read them, that the trial court's order would lead to "procedural gamesmanship," and that the trial court's order was contrary to the "separability rule" set out by the United States Supreme Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967).

Strotz filed a responding brief in which she argued that the trial court's order was consistent with state and federal law, including *Prima Paint*, and that the order was properly based on Strotz' pleadings and declarations, which sufficiently alleged fraud in the execution and inducement of the agreements and the arbitration clauses

therein. Strotz further argued that under California law, Petitioners had a fiduciary or confidential relationship with Strotz which gave rise to a duty to disclose to her all material facts about the agreements and transactions.[3] The California Court of Appeal affirmed the trial court's order in an opinion filed on August 27, 1990. *See* Pet.App.A.

Petitioners sought rehearing in the Court of Appeal, which was denied on September 21, 1990. Petitioner's Petition for Review to the Supreme Court of the State of California was denied on November 14, 1990. Petitioners filed their Petition for Writ of Certiorari on February 12, 1991. Respondent received the Petition on February 15, 1991.

MISSTATEMENTS OF FACT AND LAW IN THE PETITION FOR WRIT OF CERTIORARI SUPPORT DENIAL OF THE PETITION

The Petition before this Court contains material misstatements of fact and law which mandate denial of the Petition. Petitioners incorrectly state the substance of Strotz' fraud allegation is that she did not read the subject contracts before signing them. *See* Petition at 3 n.1. In fact, the substance of Strotz' fraud allegations is that Petitioners had a fiduciary duty to advise her of all material facts concerning the nature and effect of the documents she was signing, as well as the nature of the

---

[3] This rule of law was set forth in *Main v. Merrill Lynch, Pierce, Fenner & Smith*, 67 Cal.App.3d 19, 32, 136 Cal.Rptr. 378 (1977), and *Ford v. Shearson Lehman American Express, Inc.*, 180 Cal.App.3d 1011, 1020, 225 Cal.Rptr. 895 (1968).

investments recommended, that Strotz unknowingly signed contracts in which she waived her rights to trial of any disputes arising therefrom, and that Petitioners actively concealed and suppressed these material facts, in violation of their fiduciary duty, thereby committing fraud upon Strotz.

The California courts long ago established that a confidential relationship exists between a securities broker and its client. *Ford v. Shearson Lehman American Express, Inc.*, 180 Cal.App.3d 1011, 1020, 225 Cal.Rptr. 895 (1986); *Main v. Merrill Lynch, Pierce, Fenner & Smith*, 67 Cal.App.3d 19, 31-33, 136 Cal.Rptr. 378 (1977). Where a fiduciary or confidential relationship exists, the party with the superior knowledge has a duty to disclose all material facts to the other party. The *Main* court stated, at page 32:

> It is the settled law of this state, and elsewhere, that " '[W]here there exists a relationship of trust and confidence it is the duty of one in whom the confidence is reposed to make full disclosure of all material facts within his knowledge relating to the transaction in question and any concealment of material fact is a fraud.' " [Citations.] " 'Where there is [such] a duty to disclose, the disclosure must be full and complete, and any material concealment or misrepresentation will amount to fraud sufficient to entitle the party injured thereby to an action.' " [Citations.]

See also Ford, 180 Cal.App.3d at 1020 (citing *Main*). The existence of this relationship relieves a party from the failure to read documents. *See* Pet.App.A at 14a.

The second factual misrepresentation is Petitioners' claim that Strotz failed to allege in the first amended complaint that the arbitration agreements contained in the 1985 contracts were obtained by fraud. *See* Petition at 3, 4. In fact, Strotz plainly alleged in the first amended complaint that she was not advised of the agreements to arbitrate, and that she did not know the true nature and effect of the documents she signed or the agreements to arbitrate contained therein. *See* Pet.App.A at 3a. Strotz also alleged that the 1985 contracts were invalid based on fraud in the execution of the agreements and the arbitration clauses as well as fraud in the inducement. Further, the declarations of Strotz, submitted to the trial court in opposition to Petitioners' petition to compel arbitration, contained testimony going directly to the arbitration agreements. *See* Pet.App.A at 3a-4a.

Third, Petitioners incorrectly argue "the alternative theory" in the *Ford* case, relied on by the California Court of Appeal herein, was not briefed or argued by the parties. *See* Petition at 6. This theory states that if a party is unaware he is signing any contract, and the contract contains an arbitration clause, the party is also unaware that he is agreeing to arbitration. Therefore, an allegation of fraud in the inception or execution of the contract is necessarily directed at both the principal contract and the arbitration agreement contained therein. *See* Petition at 13; Pet.App.A at 12a-13a.

Contrary to Petitioners' contention, the first amended complaint and the declarations of Strotz set forth sufficient allegations of fraud in the execution of the agreements and the arbitration clauses. Strotz argued the agreements and the arbitration clauses therein were

obtained through fraud in the execution in her opposition to the petition to compel arbitration and responding brief on appeal. The facts and the law on this issue were therefore properly before the Court of Appeal.

These errors undermine the instant Petition and demonstrate that no substantial unsettled federal question is presented therein. The question presented to this Court was properly rejected by the California courts of appeal, in harmony with the applicable federal and state law. Therefore, Strotz respectfully submits the Petition should be denied.

REASONS FOR DENYING THE PETITION

The decision of the California Court of Appeal does not, as Petitioners contend, seriously threaten the enforcement of arbitration agreements. Neither does the decision contradict the express language of the Federal Arbitration Act and the applicable decisional law. Taken to its logical extension, Petitioners' theory is that all arbitration agreements are enforceable, even where they are procured through fraud. This contention, and not the decision, is contrary to law.

I. THE DECISION OF THE CALIFORNIA COURT OF APPEAL IS CONSISTENT WITH THE LANGUAGE OF THE ARBITRATION ACT AND THE SEPARABILITY RULE.

Petitioners incorrectly argue the theory of fraud in the execution relied on by the California Court of Appeal is contrary to the language of the Federal Arbitration Act and the "separability rule" set forth by this Court in *Prima Paint*[4]. This argument lacks any merit. The express language of the Federal Arbitration Act and the decisional law mandate enforcement of arbitration agreements only where a valid arbitration agreement exists.

Section 2 of Title 9 of the United States Code provides in pertinent part:

> [A] written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, *save upon such grounds that exist at law or in equity for the revocation of any contract.*

(Emphasis added.) The "savings clause" creates a statutory exception to the mandatory language in Section 2.[5]

In enacting the savings clause, Congress excluded from arbitration those contracts which are revocable on legal or equitable grounds. In *Prima Paint*, this Court

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[4] Petitioners expressly admit the California Court of Appeal recognized this rule. *See* Petition at 11-12; Pet.App.A at 5a.

[5] Sections 3 and 4 of the Arbitration Act also expressly contemplate court adjudication if the making of the arbitration agreement is at issue. 9 U.S.C. §§ 3, 4.

stated, at 388 U.S. 404 n.12, 18 L.Ed.2d 177 n.12 (emphasis added):

> [T]he purpose of the Congress [in enacting the savings clause of the Arbitration Act] in 1925 was to make arbitration agreements as enforceable as other contacts, but not more so. *To immunize an arbitration agreement from judicial challenge on the ground of fraud in the inducement would be to elevate it over other forms of contracts – a situation inconsistent with the "savings clause."*

Thus, the Arbitration Act, as interpreted by the United States Supreme Court, specifically creates an exception to the rule that arbitration is mandatory, where, as here, the arbitration agreement is procured through fraud.

In *Prima Paint*, this Court found that arbitration clauses are separable from the contracts in which they appear, and that if there are no allegations that the arbitration clauses were procured through fraud, the arbitrator should determine whether the principal contract was induced by fraud. 388 U.S. at 402. The *Prima Paint* Court stated, at 388 U.S. 403-404:

> [I]f the claim is fraud in the inducement of the arbitration clause itself – an issue which goes to the "making" of the agreement to arbitrate – the . . . court may proceed to adjudicate it.

The *Prima Paint* decision is in harmony with the earlier decision of this Court in *Moseley v. Electronic & Missile Facilities, Inc.*, 374 U.S. 167, 83 S.Ct. 1815, 10 L.Ed.2d 818 (1963). In *Moseley*, this Court ruled that where a complaint alleges the entire agreement, including an arbitration clause within it, was induced or procured by fraud, or that voluntary assent was lacking, the issues

of fraud and lack of assent are for the court to adjudicate. *Id.* at 374 U.S. 171. In these circumstances, the court must refuse to compel arbitration. This rule of law was expressly approved in *Prima Paint.* 388 U.S. 403-404 and n.12.

These cases teach that where there is an allegation that an arbitration agreement was procured by fraud, the court must adjudicate the issues of fraud and lack of voluntary assent. As this Court stated in *Moseley,* at 374 U.S. 171 (emphases added):

> Under . . . the Arbitration Act, it seems clear that the issue of fraud should first be *adjudicated* before the rights of the parties under the subcontract can be determined. *It appears necessary, therefore, that the district court proceed first to trial of this issue* . . . .

In *Cohen v. Wedbush, Noble, Cooke, Inc.,* 841 F.2d 282 (9th Cir. 1988), the Court of Appeals for the Ninth Circuit found that an allegation of a failure to advise a client of an arbitration clause goes to the issue of the validity of assent to the arbitration clause and not to the principal agreement. The court stated:

> The contention that Wedbush fraudulently misled the Cohens by failing to inform them of the arbitration clause is not aimed at the entire contract; it bears directly on the validity of their assent to the arbitration clause. This issue is therefore not suitable for arbitration and the courts "may proceed to adjudicate it."

Cohen, 841 F.2d at 286, quoting *Prima Paint,* 388 U.S. at 404. Similarly, in *Cancanon v. Smith Barney, Harris, Upham & Co.,* 805 F.2d 998 (11th Cir. 1986), the court stated, at page 1000:

> Where misrepresentation of the character or essential terms of a proposed contract occurs, assent to the contract is impossible. In such case there is no contract at all.

The *Cancanon* court concluded, at page 1000 (footnote omitted):

> [W]here the allegation is one of fraud in the factum, i.e., ineffective assent to the contract, the issue is not subject to resolution pursuant to an arbitration clause contained in the contract documents.

In the instant case, Strotz specifically alleged both the arbitration agreements and the agreements in which they appeared were procured through fraud in the execution and fraud in the inducement. *See* Pet.App.A at 3a. On these facts, the California Court of Appeal herein correctly found that if a person does not even know she is signing a contract, she cannot possibly be voluntarily assenting to any of the provisions of the contract or to a "separable" arbitration agreement contained therein. *See* Pet.App.A at 12a-13a. Therefore, the issue of fraud is for the court, not the arbitrator. *Id.* at 14a. In reaching this conclusion, the Court of Appeal correctly relied on and followed federal law. *Id.* at 12a-13a. Thus, the decision of the Court of Appeal is in harmony with the language of the Arbitration Act and the separability rule set forth in *Prima Paint*. The Court of Appeal simply followed the reasoning stated in the concurring opinion in *Moseley*, 374 U.S. at 172:

> We agree with the Court that fraud in the procurement of an arbitration contract, like fraud in the procurement of any contract, makes it void and unenforceable and that this question of fraud is a judicial one, which must be determined by a court. To allow this question to be

decided by arbitrators would be to that extent to enforce the arbitration agreement even though steeped in the grossest kind of fraud.

II. THE DECISION OF THE CALIFORNIA COURT OF APPEAL DOES NOT UNDERMINE THE GOALS OF THE ARBITRATION ACT

Petitioners erroneously contend the decision of the California Court of Appeal undermines the goals of the Arbitration Act by threatening the enforcement of arbitration agreements and by allegedly fostering litigation. These concerns are illusory. In fact, the decision furthers the goals of the Act and will decrease litigation by encouraging full disclosure of all material facts to investors.

The policy of the Federal Arbitration Act is to enforce valid arbitration agreements to which the parties genuinely assented. 9 U.S.C. § 2. The Act does not require parties to arbitrate when they have not agreed to do so. *Volt Information Sciences, Inc. v. Stanford University*, 489 U.S. 468, 477, 109 S.Ct. ___, 103 L.Ed.2d 488, 489 (1989). Thus, Petitioners go too far in contending the Act requires the enforcement of all arbitration agreements, even those procured by fraud. Acceptance of this theory would render meaningless the "savings clause" in Section 2 of the Act and the express statement of this Court in *Prima Paint*, that arbitration agreements are not more enforceable than any other contracts. 388 U.S. at 404 n.12. The goals of the Act require arbitration only under valid arbitration agreements.

Petitioners vainly argue the decision permits a party to avoid contractual obligations by merely alleging a

failure to read an agreement before signing it, thereby encouraging "procedural gamesmanship." This argument conveniently ignores the fact that under California law, stockbrokers owe their clients a fiduciary duty to disclose all material facts concerning the documents being signed and the rights being waived. It cannot be seriously argued that it was immaterial that the documents which Petitioners represented as forms to open an account were in fact contracts, which contained arbitration clauses and affected Strotz' legal rights. The Court of Appeal did not approve procedural gamesmanship, but rather properly refused to relieve stockbrokers of their duty to inform their clients that they are signing contracts which affect their legal rights and are not just filling out innocuous forms.

The only arbitration agreements affected by the decision will be those where, as here, the stockbrokers breached their fiduciary duty. Taken to its limit, Petitioners' theory would preclude all allegations of fraud in the execution or inducement of the agreements, thereby impermissibly enforcing all arbitration agreements, even those procured by fraud. The Court of Appeal properly rejected this argument.

Petitioners' concerns respecting an alleged increase in litigation are unfounded. The decision of the California Court of Appeal will discourage litigation by motivating stockbrokers to advise their clients fully concerning the nature of the agreements they are signing and the rights they are waiving. Contrary to Petitioners' contentions, the decision promotes the goals of the Arbitration Act.

III. THE DECISION OF THE CALIFORNIA COURT OF APPEAL IS NOT PREEMPTED BY FEDERAL LAW UNDER THE ARBITRATION ACT.

Petitioners incorrectly argue the decision of the Court of Appeal is preempted by federal law because (1) the decision purportedly "contradicts" the separability rule established in *Prima Paint*, and (2) the decision purportedly imposes an obstacle to accomplishing the goals of the Arbitration Act. As discussed in Sections I and II, *supra*, the decision of the California Court of Appeal is in harmony with the separability rule and the goals of the Arbitration Act.

Nevertheless, Petitioners erroneously contend the decision places burdens on arbitration agreements that do not apply to contracts generally. This argument was properly rejected by the California Court of Appeal. The decision does not establish a special rule for invalidating arbitration agreements. In *Perry v. Thomas*, 482 U.S. 483, 107 S.Ct. 2332, 96 L.Ed.2d 428 (1987), this Court expressly approved the application of state law principles when a court is determining whether an arbitration agreement is revocable. This Court stated, at 96 L.Ed.2d 437 n.8b (emphasis in original):

> An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law* [citation], "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. section 2 (emphases added). Thus, state law whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.

See also Southland Corp. v. Keating, 465 U.S. 1, 17 n.11, 104 S.Ct. 852, 79 L.Ed.2d 1, 16 n.11 (1984).

The California Court of Appeal did not base its holding on state law principles that take their meaning solely from the fact that an arbitration agreement was involved. Nor did the Court of Appeal create or impose special burdens on agreements to arbitrate. Rather, the Court of Appeal looked to general contract law principles regarding fraud in the execution of contracts. *See* Pet.App.A at 12a-14a.

Finally, Petitioners misstate the law in arguing that no other court has created a fiduciary duty on a stockbroker to explain the terms of a contract to a client. *See* Petition at 14. This argument ignores the clear language of the *Cohen, Ford* and *Main* cases.

The decision of the California Court of Appeal properly looked to general contract law principles. Therefore the decision does not conflict with federal law and is not subject to preemption.

CONCLUSION

For the foregoing reasons, Respondent Linda Strotz respectfully requests this Court to deny the instant Petition For A Writ Of Certiorari.

Respectfully submitted,

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